

## **Seminar F**

# **IFA/EU: State aid review as a means to combat aggressive tax planning**

## Presentation of the panel

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# Agenda

- Introduction
- State aid and aggressive tax planning
  - Framework
  - Legislative acts
  - Acts of tax administration
- Recovery issues
- Switzerland



# + Introduction

## State aid prohibition

### State aid = Four cumulative conditions

- Economic advantage
- Granted through State resources and imputable to a Member State (also mitigation of (tax) charges)
- Liable to distort competition and affect trade between the Member States
- Favouring certain undertakings or the production of certain goods ('selectivity')

## State aid and (direct) taxation

### Tax sovereignty of MS

- Free to design national tax system
- Revenue objectives / policy objectives

### State aid rules

- “Effects”-doctrine
- Policy objectives do not prevent measure from being State aid

*“Although direct taxation falls within the competence of the Member States, they must exercise that competence consistently with EU law” (established ECJ case law)*

## State aid procedure

### Article 108 TFEU and Procedural Regulation

- Notification and standstill obligation
- European Commission assessment of compatibility (Article 107(3) TFEU)
- Recovery of illegal and incompatible aid
- Litigation in EU and national courts

# + State aid and aggressive tax planning

Framework





# Relevance

Timeline	
December 2012	Action Plan European Commission (State aid included)
Feb/July 2013	BEPS report and action plan
Summer 2013	Start of preliminary examinations DG COMP
February 2014	Commissioner Almunia's statement at EU Competition Forum
June 2014	Formal investigations (Apple, Fiat, Starbucks)
October 2014	Formal investigation (Amazon)
October 2014	Extension of investigation (Gibraltar)
December 2014	Preliminary examination (rulings of all MSs between 2010-2013)
February 2015	Formal investigation (Belgian Excess Profit Rulings)
March 2015	EC Tax Transparency Package (incl. Proposal for Directive on exchange of rulings)
Spring 2015	Press reports (deferred tax assets, McDonalds, etc.)
June 2015	EC requests individual rulings from 15 Member States
July 2015	Draft report of special committee on tax rulings of European Parliament (TAXE)

## Assessment framework

### Aid through tax legislation

- Tax legislation itself may confer State aid

### Aid through administrative tax practices

- Application of legislation by authorities may confer aid
- *Ex ante* (ruling, authorisation) or *ex post* (settlements)

## **+ State aid and aggressive tax planning**

Aid through tax legislation

## Topics

- Hybrid entities
- Group interest box regimes
- Anti-abuse measures
- Transfer pricing rules
- Tax treaties



# Advantage and selectivity as contentious conditions

## Economic advantage

- Improvement of financial situation of an undertaking as a result of State intervention
- Comparison of financial situations with and without tax measure concerned ('but for' test)
- Any stage of taxation process (base, rate, tax recovery, etc.)



# Selectivity and advantage as contentious conditions

## Selectivity

- Tax measure creates differences between taxpayers which, in light of objective of measure in question, are in a comparable factual and legal situation
- Underlying issue of (un)equal treatment
  - Reverse discrimination can be State aid

## ,Selective advantage‘

### Conceptual - mixing of ‘advantage’ and ‘selectivity’

- Two separate conditions
- Both require comparison, but ‘reference framework’ not necessarily identical
  - Advantage: comparison of beneficiaries’ financial position with and without the measure
  - Selectivity: comparison of beneficiaries’ financial position to that of other undertakings in a similar legal and factual situation

## ,Selective advantage‘

### Three-step approach

- Determination of the ‘reference system’
- Derogation of reference system insofar as it differentiates between undertakings which, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation (prima facie selectivity)
- Justification by nature and general scheme of system
  - Intrinsic logic of the reference system



# ,Selective advantage‘

## Choice of ,reference system‘ is crucial

- Pre-determines outcome of three-step approach
- Tendency of EC / ECJ to
  - Adopt broad reference system, i.e. corporate tax system with objective of taxing corporate profits
  - Consider any derogation as prima facie selective
  - Require MSs to justify (prima facie selective) derogations
  - Only consider objectives intrinsic to reference system as justification
  - Proportionality, i.e. no less distortive measure available

## + Recent developments

- Selectivity is expression of principle of equality
  - Equal treatment of comparable situations; unequal treatment of incomparable situations to the extent of incomparability
  - Comparability in equal treatment cases is predominantly determined in light of the objective of the measure creating the distinction in question (not in the abstract)
- However, differential treatment of comparable situations is not enough in order to consider a measure selective > privileged category of undertakings/productions needed

## Recent developments

### Banco Santander (T-399/11) and Autogrill (T-219/10)

- Goodwill amortization possible only for acquisitions of at least 5% of shares of non-Spanish companies
- General Court – no selectivity
  - Derogation from reference framework and/or requirement to fulfil certain conditions does not necessarily imply (prima facie) selectivity
  - Measure aimed at a category of economic transactions (not a category of undertakings) and undertakings must not, a priori, change their activities to benefit from measure
  - Definition of category of undertakings which are exclusively favoured by measure at issue is a prerequisite for selectivity
- Case appealed to ECJ

## + Hybrid entities

- Advantage?
  - ACo: interest not taxed in MS A
  - BCo 1/BCo 2: able to off-set interest in consolidation
- Selectivity?
  - *De facto* beneficial only for cross-border operations
  - Not selective if resulting from mere disparity, i.e. MS A and B indiscriminately classifying similar (foreign and domestic) entities as opaque or transparent
    - MS A: classification as transparent entity, leading to disregarding internal transactions
    - MS B: classification as opaque entity, resulting in it being able to serve as head of a tax consolidation



## Group interest box regimes

- Advantage and selectivity?
  - Interest taxable at 5% instead of 25%
  - Only for group companies / de facto beneficial only in cross-border context
- EC decision C(2009) 4511
  - Assessment of aid at individual entity (not group) level
  - No aid because
    - No selectivity – loans between group companies are not comparable to loans between unrelated companies, and ‘group’ requirement can easily be fulfilled (setting up a company is easy)
    - Not attributable to MS – no special provisions apply in cross-border vs. national context, so that advantage arising in cross-border context is result of a **disparity** (not attributable to MS B)

## + Anti-abuse rules

- Are MS obliged to enact anti-abuse rules ('AAR') in non-harmonized direct taxation?
  - Sovereign decision by MSs to exercise taxing powers
    - *3M Italia*: no obligation to counter abuse of domestic (not EU) law
  - If AAR, should undertakings committing abuse and those not committing abuse be treated equally, i.e. because they are comparable?
    - Yes, anti-abuse rule restores equal treatment, assessment of penalties prima facie selective but justified by prevention of tax avoidance
    - Yes, providing derogations (i.e. explicit non-application of rule) to specific undertakings or transactions is selective (*Commission Draft Notice on notion of aid or 'NOA', §184*)

# + Transfer pricing rules

- Commission's view
  - MSs obliged to enact transfer pricing rules / arm's length principle (ALP) in domestic law?
    - MNEs should be assessed on a tax base comparable to that of independent enterprises (*Forum 187-case*)
    - ALP enacted in domestic law or apply it *de facto*
  - OECD Guidelines are a reference document
  - Concept of prudent independent market operator

## Transfer pricing rules

- Three-step approach applied to transfer pricing
  - Reference framework
  - Prudent independent market operator in light of OECD TPG
  - OECD TPG are only an authoritative source of interpretation
- IFA Cancun 1992



## + Illustration

- Belgian Excess Profit Deduction Regime
  - Proactive downward adjustment under national law / tax treaty Article 9
  - Reference framework
    - Article 185, para 1 (taxation on net accounting profit)
    - Article 185, para 2, a) (ALP)
    - Article 185, para 2, b) (downward adjustment)
  - Misapplication of domestic law?



## Double non-taxation under tax treaties

- Advantage?
  - ACo: branch profits of State B exempt in MS A
- Selectivity?
  - *De facto* beneficial only in bilateral treaty context
  - Can tax treaties confer State aid?
    - Awards under BIT may confer aid (*Micula - C(2014) 6848*)
  - Are residents of MS A with branches in State B comparable to residents of MS A with branches in State C ?
    - In context of freedoms, ECJ accepts that no MFN treatment should apply (*D-case*)

## **+ State aid and aggressive tax planning**

Aid through administrative tax practices

## + Commission guidance - general

- General concern: *discretionary powers* of tax authorities, especially where the exercise thereof goes beyond simple management of tax revenue by reference to objective criteria (*P Oy*)
- Unsound administrative tax practices
  - Tax rulings
  - Tax settlements
  - Tax authorisations



## Commission guidance - tax rulings

- Tax rulings are acceptable if they merely provide legal certainty, but not if they lead to lower taxation than that of other undertakings in similar legal and factual situation (but which were not granted such rulings)
- Presumptions
  - **No presumption of aid** if administrative decision merely contains interpretation of relevant tax provisions without deviating from case law and practice (**'interpretative ruling'**)
  - **Presumption of aid** if administrative decision departs from general tax rules and benefits individual undertakings (**'derogatory ruling'**)

## + Open questions

- Distinction between ‘derogatory’ and ‘interpretative’ ruling? Where to draw the line and by whom?
- Statute provisions may be vague and case-law and/or practice may not exist or be far from settled?
  - Aid through tax legislation (*P Oy-case*)
- Is obtaining legal certainty through an interpretative ruling in itself conferring a selective advantage?



## Commission challenges in pending investigations

- Determination of taxable basis is ‘negotiated’ / ‘fixed’
- Absence of TP study
- Comparability analysis is incorrect or absent
- Choice of TP methods is incorrect
- TP methods are incorrectly applied
- Choice within TP range challenged
- Royalty payments as residual profit
- Open-ended nature (term of ruling)

## + APAs and selective advantages

- Comments from TP practitioner
  - No single ‘arm’s length result’ > use of TP ranges
    - Even if all countries involved in an intra-group transaction abide to OECD TPG, key differences exist in national application thereof
  - Tested party concept
  - Choice of TP methods vis-à-vis functionality and risk profile
  - Availability of TP study
  - ‘Dynamic’ interpretation of OECD TPG
  - Prudent independent market operator
    - Benchmarking does not establish one precise reference value but a range of reference values by assessing a set of comparables (*NOA*, §103)
  - Opportunity assessment ?



## + Recovery issues

## General aspects

- Commission in principle obliged to order recovery of unlawful and incompatible aid, with two exceptions
  - Protection by general principles of EU law
  - Protection by 10-year limitation period
- Quantification of recovery by Commission or MS
- Determination of beneficiary
- Decision to be implemented by Member State
- Procedure before national courts and EU courts



# Impact of general principles of EU law

- General principles of EU law
  - Proportionality
  - Legal certainty
  - Protection of legitimate expectations
  - Absolute impossibility
- Restrictive application



## Quantification of recovery amount

- Aim of recovery is to reclaim economic advantage from recipients and restore *status quo ante*
  - Recovery is not a penalty
- Amount of recovery traditionally quantified as delta between amount of tax
  - Which has actually been paid and
  - Which would have been paid without the aid measure
- Compound legal interest added



## Specific issues related to recovery amount

- Intricate questions related to determining the amount of tax paid absent the aid measure
  - Impact of alternative options available (facts)
  - Impact of alternative options available (tax regimes)
  - Impact of generally available tax corrections (e.g. losses)
  - Impact of recovery in MS1 in combination with upward TP adjustment in MS2 = double taxation (protection under art. 9(2) OECD MC and Arbitration Convention)?
- *Aer Lingus-case*
  - Reduced rate of indirect tax passed on to consumers (<> direct tax, §89)



**+ Switzerland**

## + Legal framework

- Switzerland is a third country vis-à-vis EU law
- EU-Swiss Free Trade Agreement of 22 July 1972
  - Article 23(1)(iii): “(...) *are incompatible with the proper functioning of the [FTA] in so far as they may affect trade between the [EU] and Switzerland: [...] any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods*”

## Key differences FTA and TFEU

- Scope of application (Article 2)
  - Limited to products originating in EU or Switzerland
  - NOT: services, goods in transit or originating in 3<sup>rd</sup> States
- State aid definition (Article 23(1))
  - Only embeds equivalent of Article 107(1) TFEU
  - NOT: compatibility grounds of Article 107(2) and (3) TFEU
- Sanctions (Article 27)
  - Compensatory measures (tariffs) on goods
  - NOT: Recovery



## + EU perspective

- Unilateral declaration: Article 23(1)(iii) to be applied in line with art. 107 et seq. TFEU
  - As per the decision of European commission of 13.2.2007, Swiss privileged regimes (in particular auxiliary and holding regimes) considered to be unlawful state aid
  - On the other hand, language of the decision is also interesting in that it does not exclude that other selective fiscal measures pursuing objectives of common interest may be considered to be compatible with the Agreement

## Swiss perspective

- Switzerland has always strongly disputed the (dynamic) interpretation of art. 23(1)(iii) of the Agreement to corporate tax measures, in particular the cantonal regimes
- Almost compromise in 2009 but resistance from number of EU Member States
- In June 2010, the EU put forward a proposal to Switzerland to conduct talks on the Code of Conduct for Business Taxation
- Mandate for discussions was adopted by Federal Council in July 2012



## Joint Swiss-EU statement of 14.10.2014

- *“Without prejudice to existing international agreements the parties recognise the essential features constituting **harmful tax competition** and acknowledge that at international level these features are reflected in specific principles and criteria at the OECD and within the EU at EU level”*
- *« the Swiss Federal Council has expressed an intention **that any possible replacement measures will need to be in line with generally accepted international standards** (...). The Swiss Federal Council therefore intends to adopt draft legislation and open the compulsory consultation process with the cantons, political parties and other interested groups as soon as possible »*



## Joint Swiss-EU statement of 14.10.2014

- Debate has thus shifted from state aid to harmful tax competition
- Open question for the future: to what extent the 1972 Agreement may still be relied upon in the future by the EU as regards the adoption by Switzerland of new tax incentives in case they are regarded as selective ?



**+ Thanks for your attention**

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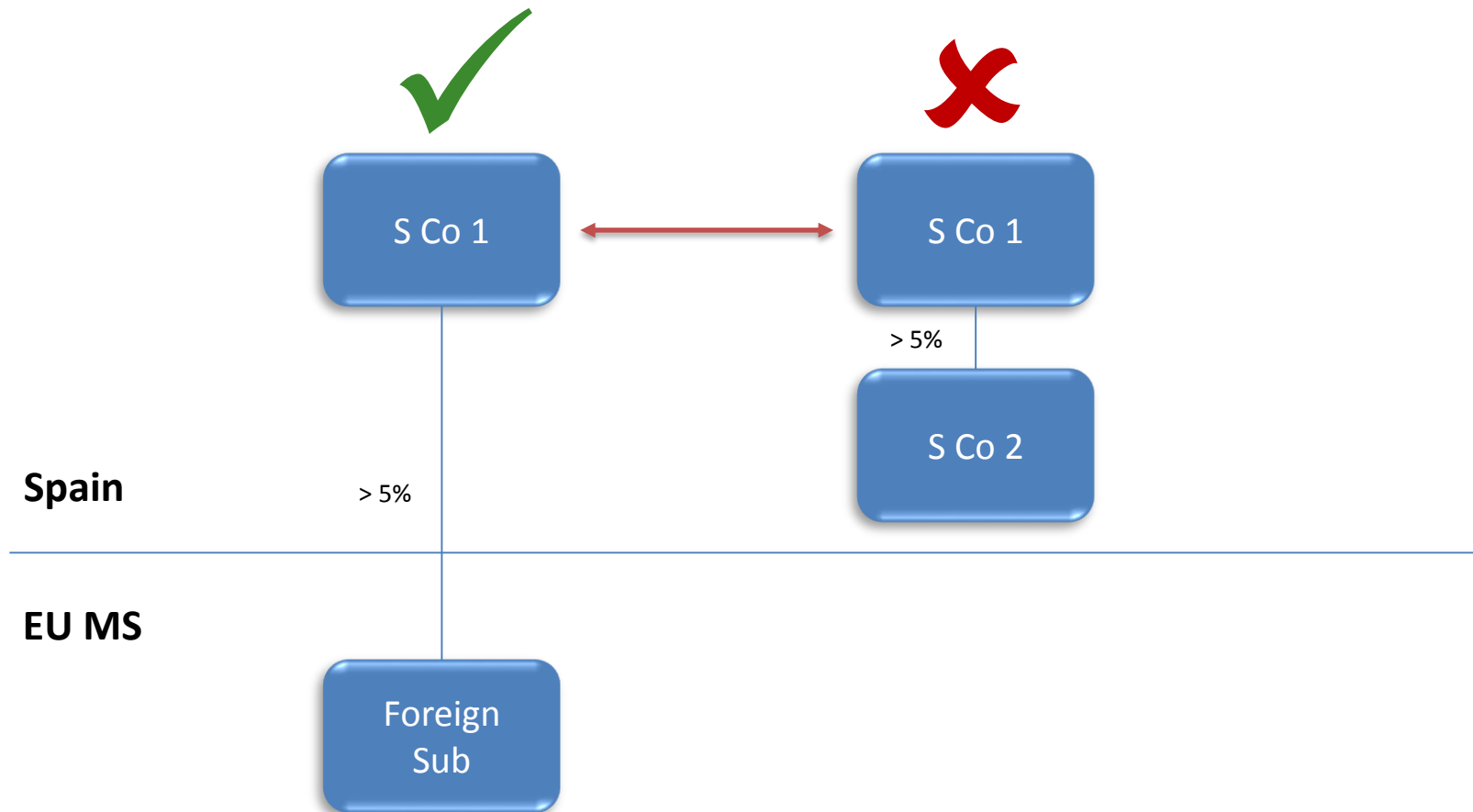
## State aid prohibition

### Article 107(1) TFEU

- *“(...) any aid granted by a MS or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between MSs, be incompatible with the internal market”*
- Addressed at EU Member States, not taxpayers

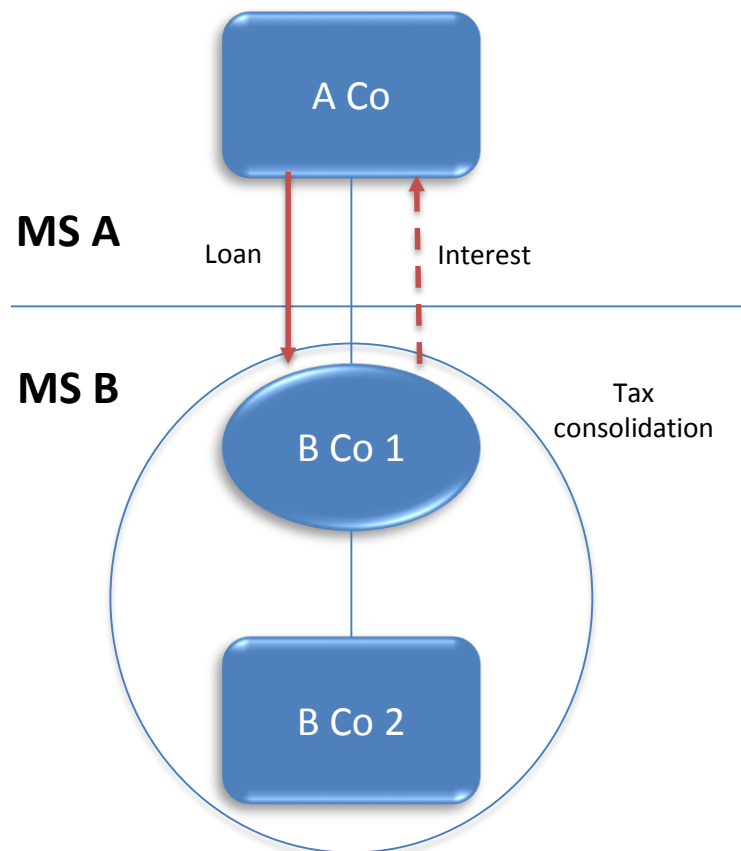
# + Recent evolutions

## Banco Santander (T-399/11) and Autogrill (T-219/10)



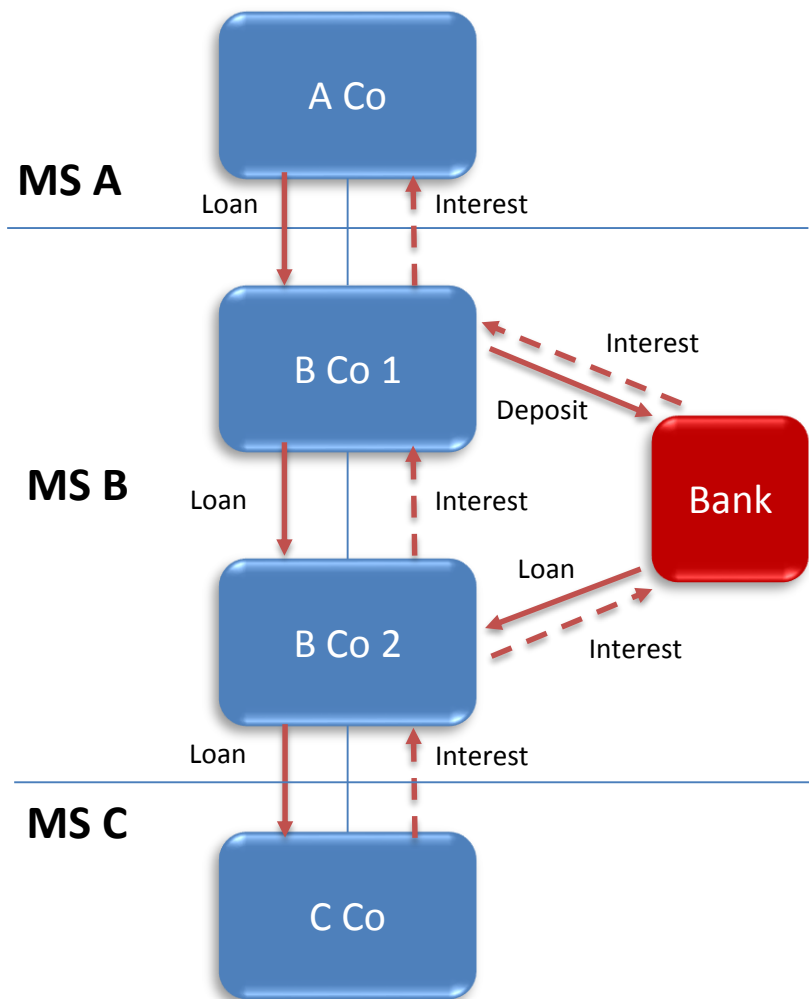


# + Hybrid entities



- Taxation in MS A
  - B Co 1 considered as tax transparent (branch of A Co)
  - Internal interest income not recognised / taxable
- Taxation in MS B
  - B Co 1 considered as opaque (taxable entity)
  - B Co 1 has no profits
  - B Co 1 interest expense set off in consolidation against B Co 2 income
- Deduction / non-inclusion

# + Group interest box regimes



- Taxation in MS A
  - Interest income taxable at 30%
- Taxation in MS B
  - Interest income taxable and interest expense deductible at 25%
  - Within groups, interest paid and received is taxable and deductible at 5% (compulsory regime)
- Taxation in MS C
  - Interest expense deductible at 30%
- Tax rate arbitrage

# Anti-abuse rules

	Abuser	Non-abuser
Reported taxable base	100	150
Taxable base reduction attributable to abuse *	50	0
Increase of taxable base further to anti-abuse rule	50	0
Adjusted taxable base	150	150
Tax penalty	YES	NO

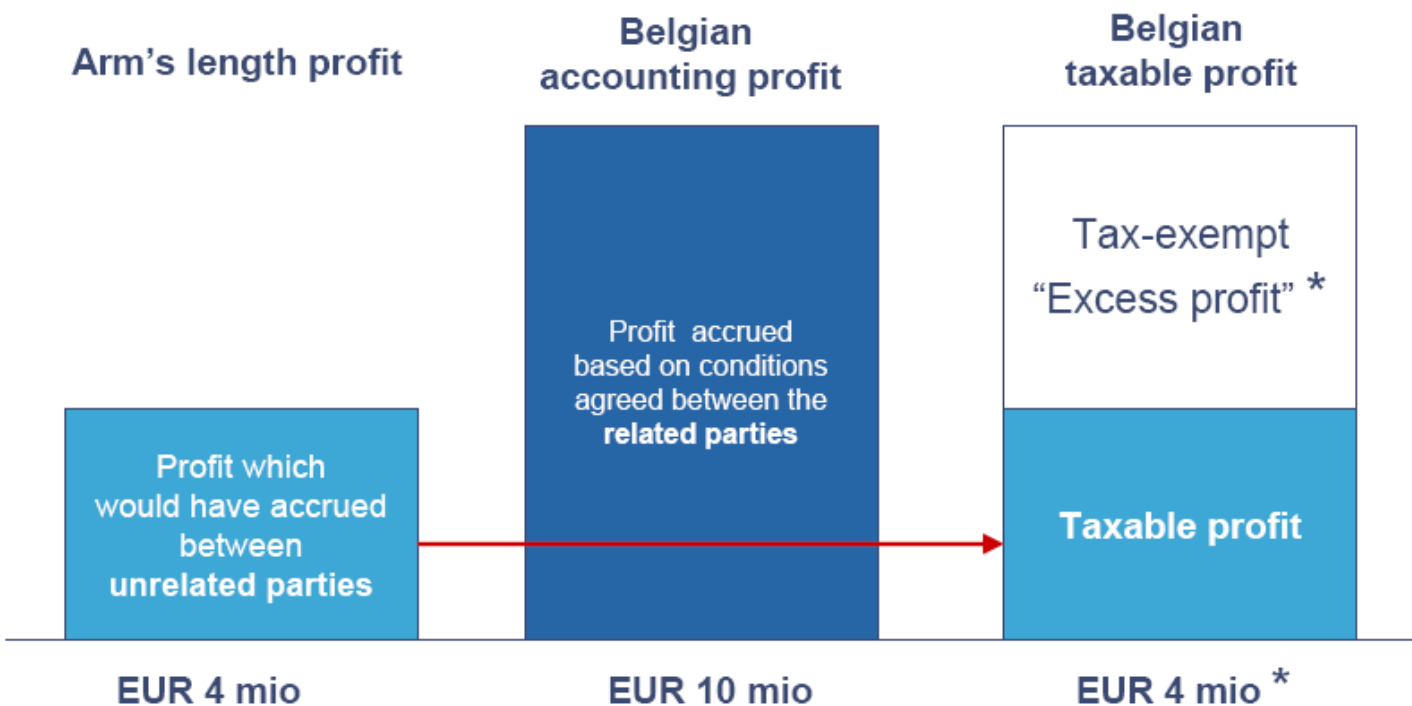
## \* Abuse

- Inappropriately claiming tax deduction / exemption
- Inappropriately avoiding taxing provision

# + Transfer pricing rules

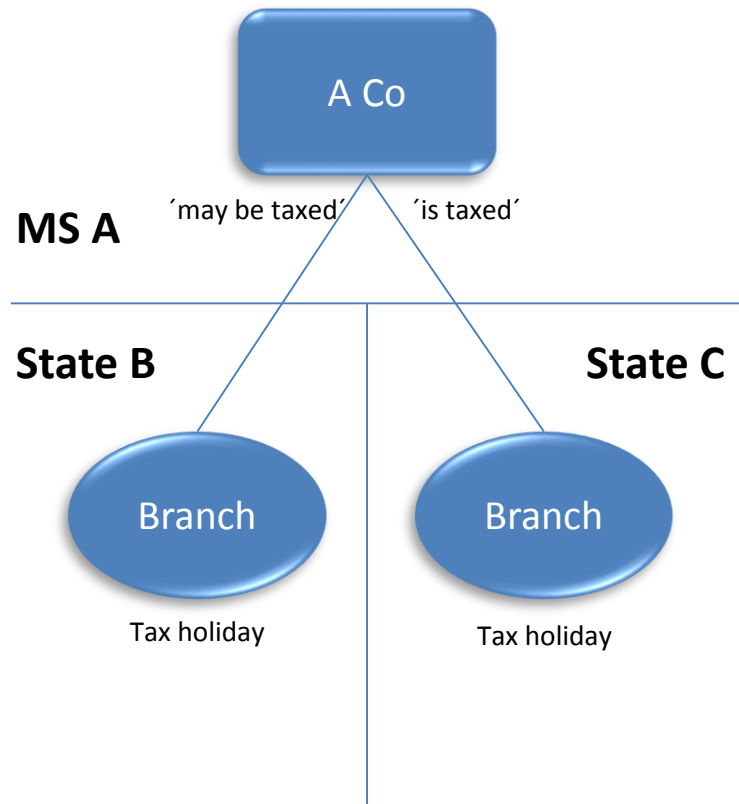
Art. 185,§2,b) BITC

## “Downward” profit adjustment





# Double non-taxation under tax treaties



- Taxation in MS A
  - Branch income exempt in MS A (further to A/B tax treaty relief in MS A if income “may be taxed” in State B)
  - Branch income not exempt in MS A (further to A/C tax treaty relief in MS A only if income “is taxed” in State C)
- Taxation in State B and C
  - Assumption: third State
  - Tax holiday for x years



## Commission preliminary conclusion in pending cases

- *“Based on the above, the Commission is of the opinion that the APA does not comply with the arm’s length principle. Accordingly, the Commission is of the opinion that through the APA the tax authorities confer an **advantage**. That advantage is obtained every year and on-going, when the annual tax liability is agreed upon by the tax authorities in view of APA”*
- *“That advantage is also granted in a **selective** manner. While tax rulings that merely contain an interpretation of the relevant tax provisions without deviating from administrative practice do not give rise to a presumption of a selective advantage, rulings that deviate from that practice have the effect of lowering the tax burden of the undertakings concerned as compared to undertakings in a similar legal and factual situation. To the extent the tax authorities have deviated from the arm’s length principle as regards the contested [APA, it] should also be considered selective.”*



**+ Thanks for your attention**